

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**



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In the Matter of the Application of  
California-American Water Company (U  
210 W) for an order authorizing it to  
increase its rates for water service in its Los  
Angeles District to increase revenues by  
\$2,020,466 or 10.88% in the year 2007;  
\$634,659 or 3.08% in the year 2008; and  
\$666,422 or 3.14% in the year 2009

A.06-01-005

**CALIFORNIA-AMERICAN WATER COMPANY NOTICE OF EX PARTE  
COMMUNICATIONS**

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Date: June 20, 2007

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of  
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A.06-01-005

**CALIFORNIA-AMERICAN WATER COMPANY NOTICE OF EX PARTE  
COMMUNICATIONS**

In accordance with Article 8 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”), California-American Water Company (“California American Water”) hereby late files<sup>1</sup> this notice of its ex parte meeting with Commissioner Simon’s Advisor, Timothy Sullivan and Commissioner Chong’s advisor, Jane Whang.

On Wednesday, May 30, 2007, at 10:00 a.m., David Stephenson of California American Water and Lenard Weiss of Steefel, Levitt & Weiss, counsel for California American Water, met with Mr. Sullivan and Ms. Whang at the Commission. The meeting lasted approximately thirty minutes. In addition to the oral communications described below, California American Water also gave Mr. Sullivan and Ms. Whang a copy of the *Comments of California-American Water Company on the PD of Administrative Law Judge Walwyn*, filed with the Commission on May 29, 2007.

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<sup>1</sup> California American Water originally intended to timely file and serve this ex parte notice on June 4, 2007, along with notices for related ex parte meetings. It has come to our attention, however, that this notice was inadvertently omitted and was not filed on that date. California American Water filed this notice first on June 12, 2007. It was rejected because the emails discussed below referenced items that are not part of the record and these items were not attached. The current notice includes these items as attachments.

At the meeting Messrs. Stephenson and Weiss discussed the *Proposed Decision of ALJ Walwyn*, issued May 7, 2007 (“Proposed Decision”). Messrs. Stephenson and Weiss argued that the return on equity in the Proposed Decision is too low and does not properly take into account California American Water’s financial risk. Messrs. Stephenson and Weiss also argued that the proposed decision’s position that implementation of a Water Revenue Adjustment Mechanism (“WRAM”) should lead to a downward adjustment in return on equity is incorrect and premature. Finally, Messrs. Stephenson and Weiss stated that the additional restrictions placed on the Infrastructure System Replacement Surcharge (“ISRS”) were unnecessary and unduly burdensome.

Following the meeting, Mr. Weiss sent to Mr. Sullivan and Ms. Whang via email electronic copies of the comments on the Proposed Decision filed by the California Water Association (“CWA”), California Water Service Company (“CalWater”), and the Division of Ratepayer Advocates. The comments of CWA and CalWater were accompanied by their respective motions for party status. Finally, Mr. Weiss emailed Mr. Sullivan and Ms. Whang a copy of the May 29, 2007 ruling by Administrative Law Judge Grau in I.07-01-022. Appendix A contains the emails from Mr. Weiss, with the attachments.

Parties may request a copy of this notice by contacting:

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Dated: June 20, 2007

Respectfully submitted,

STEEFEL, LEVITT & WEISS  
A Professional Corporation

By: 

Lori Anne Dolqueist  
Attorneys for Applicant  
California-American Water Company

## Appendix A

**Dolqueist, Lori Anne**

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**From:** Weiss, Lenard  
**Sent:** Wednesday, May 30, 2007 2:38 PM  
**To:** 'tjs@cpuc.ca.gov'; 'jjw@cpuc.ca.gov'  
**Cc:** 'dstephen@amwater.com'; Dolqueist, Lori Anne; Weiss, Lenard  
**Subject:** FW: A.06-01-005; CWA Motion for Party Status with Comments Attached  
**Attachments:** Motion for Party Status; Comments Attached.pdf

Tim and Jane: Per our meeting this morning, attached is first of several sets of Comments recently filed relating to the PD on Cal-Am's pending Los Angeles GRC.

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**From:** Wong, Jeannie [mailto:JWong@Nossaman.com]  
**Sent:** Tuesday, May 29, 2007 4:27 PM  
**To:** tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org; creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com; dalderson@rwglaw.com; ndw@cpuc.ca.gov; Dolqueist, Lori Anne; Dolqueist, Lori Anne; dstephen@amwater.com; rball@cao.lacounty.gov; sdlee3@pacbell.net; jmarkman@rwglaw.com; Pinkie.L.Nichols@KP.Org; jvasquez@cityofbradbury.org; Weiss, Lenard; demorse@omsoft.com; darlene.clark@amwater.com; Martina@akwater.com; mrx@cpuc.ca.gov; cmw@cpuc.ca.gov; des@cpuc.ca.gov; dsb@cpuc.ca.gov; flc@cpuc.ca.gov; llk@cpuc.ca.gov; mkb@cpuc.ca.gov; nyg@cpuc.ca.gov; tfo@cpuc.ca.gov; ywc@cpuc.ca.gov  
**Cc:** Mattes, Martin; Guzman, Joe E.; jhawks\_cwa@comcast.net  
**Subject:** A.06-01-005; CWA Motion for Party Status with Comments Attached

To Parties on the Service List for A.06-01-005:

Attached please find the Motion of California Water Association for Party Status with Comments provided as Attachment A to the Motion.

Please provide a copy by electronic mail of any comments, reply comments, or other filings that you may make in

6/20/2007

this proceeding to the following representatives of California Water Association:

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Executive Director  
California Water Association  
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Martin A. Mattes  
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Thank you for your consideration.

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California-	)	
American Water Company (U 210 W) for an	)	
Order Authorizing it to Increase its Rates for	)	
Water Service in its Los Angeles District to	)	Application 06-01-005
Increase Revenues by \$2,020,466 or 10.88% in	)	(Filed January 9, 2006)
the Year 2007; \$634,659 or 3.08% in the Year 2008;	)	
and \$666,422 or 3.14% in the Year 2009.	)	
_____	)	

**MOTION OF  
CALIFORNIA WATER ASSOCIATION  
FOR PARTY STATUS**

In accordance with Rule 1.4 of the Commission's Rules of Practice and Procedure, California Water Association ("CWA") hereby submits its Motion for Party Status in the above-captioned proceeding. CWA respectfully submits this Motion for purposes of filing comments on the proposed decision of Administrative Law Judge ("ALJ") Walwyn ("PD"), entitled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)," which was released for comment on May 7, 2007. A copy of the "Comments of California Water Association on Proposed Decision of ALJ Walwyn" is appended to this Motion as Attachment A.

In support of this Motion for Party Status, CWA provides the following information:

CWA is a trade association comprised of many of the investor-owned water utilities regulated by this Commission, including seven of the ten Class A water utilities subject to Commission jurisdiction. CWA regularly represents the investor-owned water utility industry before the Commission and the California Legislature on matters of common interest to the industry. It has appeared on many occasions and in many proceedings before the Commission.



Among the proceedings in which it is an active party is I.07-01-022, an "Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities" (the "Water Conservation Proceeding") and the four applications that have been consolidated with the Conservation Proceeding. Among the subjects to be considered in the Water Conservation Proceeding is the relationship between the adoption of a water revenue adjustment mechanism ("WRAM") for an individual water utility and the utility's return on equity. The PD in this proceeding proposes to determine that relationship for California American Water Company. On behalf of its Class A water utility members, CWA seeks party status in this proceeding to address whether the relationship between a WRAM and a utility's return on equity should be more appropriately handled in a generic proceeding, such as the Water Conservation Proceeding, in subsequent cost of capital proceedings, or in this immediate GRC. Thus, CWA's proposed participation in this proceeding is pertinent to issues already before the Commission in this and related proceedings.

For all of the foregoing reasons, CWA urges the Commission to grant this Motion for Party Status and to accept CWA's comments on the PD appended hereto as Attachment A.

DATED: May 29, 2007

Respectfully submitted,

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Attorneys for CALIFORNIA WATER ASSOCIATION

**ATTACHMENT A**

**BEFORE THE PUBLIC UTILITIES COMMISSION  
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In the Matter of the Application of California- )  
American Water Company (U 210 W) for an )  
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Increase Revenues by \$2,020,466 or 10.88% in )  
the Year 2007; \$634,659 or 3.08% in the Year 2008; )  
and \$666,422 or 3.14% in the Year 2009. )  
\_\_\_\_\_ )

Application 06-01-005  
(Filed January 9, 2006)

**COMMENTS OF  
CALIFORNIA WATER ASSOCIATION  
ON PROPOSED DECISION OF ALJ WALWYN**

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May 29, 2007

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Attorneys for CALIFORNIA WATER ASSOCIATION

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and \$666,422 or 3.14% in the Year 2009.	)	
_____	)	

**COMMENTS OF  
CALIFORNIA WATER ASSOCIATION  
ON PROPOSED DECISION OF ALJ WALWYN**

In accordance with Rule 14.3 of the Commission's Rules of Practice and Procedure ("Rules"), California Water Association ("CWA") hereby submits its comments on the proposed decision of Administrative Law Judge ("ALJ") Walwyn, titled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)" ("Proposed Decision" or "PD"), which was released for comment on May 7, 2007. CWA respectfully submits these comments subject to its concurrently filed motion to become a party to this proceeding, pursuant to Rule 1.4 of the Commission's Rules.

**I.**

**CWA'S INTEREST IN THE PROPOSED DECISION**

As an industry association representing the interests of investor-owned water utilities that are subject to regulation by the Commission, CWA seeks to promote the adoption of sound water policies by the Commission and the California Legislature. In that role, CWA is participating actively in the Commission's ongoing investigation of policies to achieve

conservation objectives for Class A water utilities,<sup>1</sup> in which the parties and the Commission are considering the development of conservation-oriented rate design and the adoption of balancing account procedures, such as a Water Revenue Adjustment Mechanism (“WRAM”). Among the issues presented in the Commission’s order instituting the water conservation investigation is whether the utilities’ required return on equity should be adjusted if a WRAM is adopted. I.07-01-022, at 9.

In the context of the present general rate case (“GRC”) for California American Water Company (“California American”), the proposals of California American for a conservation rate design and a WRAM have yet to be considered. However, the Proposed Decision of ALJ Walwyn includes an assessment of the impact that adoption of a WRAM would have on California American’s business risk and on the appropriate level of the company’s authorized rate of return on equity (“ROE”). The PD would impose a 50 basis point (0.50%) downward adjustment of California American’s ROE, in the event that the Commission adopts a WRAM and a Modified Cost Balancing Account (“MCBA”) for California American in Phase 2 of the current GRC.

The imposition of an ROE adjustment based on authorization of a WRAM, as the PD proposes in the present GRC, would preempt the consideration of that issue on an industry-wide basis in the Conservation OII and would bias that proceeding. At worst, it may predetermine the result of that consideration. It also puts the cart before the horse – arbitrarily determining the precise impact on ROE of a ratemaking mechanism that has not yet been defined in detail, let alone placed into operation. Accordingly, in its role as representative of the business interests of its members in promoting sound water policies, CWA is very directly affected by the PD’s

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<sup>1</sup> *Order Instituting Investigation to Consider Policies to Achieve the Commission’s Conservation Objectives for Class A Water Utilities*, I.07-01-022, adopted January 11, 2007 (“Water Conservation OII”).

proposal to impose a downward adjustment in ROE on California American. This is why CWA is filing its concurrent motion for party status in this GRC and submitting these comments.

## II.

### **THE PROPOSED DECISION ERRS IN PREJUDGING THE RETURN ON EQUITY IMPACT OF ADOPTING A WRAM AND AN MCBA.**

The Proposed Decision defers to Phase 2 of the California American GRC the determination of rate design and of whether to adopt a WRAM and/or an MCBA. However, in anticipation that the WRAM and MCBA may be adopted, the PD determines that “there should be a concurrent .50% reduction in ROE.” PD, at 2-3.

The PD notes DRA’s contention that addition of WRAM and MCBA mechanisms “would remove virtually all Cal-Am’s business risk,” which was the basis for DRA’s recommendation of a severe ROE reduction to accompany adoption of those mechanisms. PD, at 32. The PD contrasts DRA’s reliance on prior Commission decisions addressing the financial effects of similar adjustment mechanisms approved for energy utilities with the testimony of California American’s expert that past decisions do not support an adjustment to ROE when implementing revenue adjustment mechanisms. PD, at 33. ALJ Walwyn sides with DRA, finding that the Commission “has consistently held that the adoption of revenue adjustment mechanisms . . . reduces business risk” and, in implementing these mechanisms, has “explicitly reflected this risk reduction in each utility’s adopted ROE.” PD, at 34.

To support this “finding,” the PD refers to statements about risk reduction in a series of Commission decisions, beginning with a 1978 decision authorizing the first gas supply adjustment mechanism (“SAM”), including 1981 and 1982 decisions authorizing an electric revenue adjustment mechanism (“ERAM”) for PG&E, SDG&E, and Southern California Edison, and continuing through a 1990 decision allowing a temporary WRAM for water utilities in the



context of the *Drought OII*.<sup>2</sup> PD, at 34-38. Based on this case law, the PD concludes that the Commission should make a downward adjustment to ROE to reflect reduced business risk if a WRAM and MCBA are adopted for Cal-Am. PD, at 38. Based on “informed judgment,” the PD would set that adjustment at 0.50%. *See*, PD, at 39-40.

DRA’s initial showing on this issue was minimal and was easily rebutted by California American. ALJ Walwyn, however, required both parties to submit supplemental testimony and extended the evidentiary hearing to consider these supplemental showings. This resulted in consideration of the impact of WRAM on ROE as an afterthought to the in-depth cost-of-capital analysis that was conducted in the same proceeding.

As will be explained in these comments, the PD’s determination to impose an ROE reduction in anticipation of the adoption of a WRAM and/or an MCBA is erroneous for several reasons. First, the PD ignores the context in which these new ratemaking mechanisms are being considered – the adoption of a conservation rate design that *increases* the utility’s risk. A WRAM that decouples sales from revenues is intended to reduce the level of risk associated with the loss of revenues as a direct result of the conservation methods employed and results achieved. Any reduction in the overall level of business risk that existed prior to implementation of the WRAM is incidental, if it occurs at all – and will benefit ratepayers and shareholders equally. Accordingly, no adjustment in ROE is necessary or warranted.

Second, the Commission’s Water Action Plan offers “an opportunity for higher earnings resulting from successful conservation efforts, and a sharing of savings with customers.” Water Action Plan, adopted December 15, 2005, at 10. In this context, a utility that adopts a rate design to encourage conservation and protect valuable water resources should be

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<sup>2</sup> *Re Measures to Mitigate the Effects of Drought on Regulated Water Utilities, Their Customers and the General Public*, D.90-08-055, 37 CPUC 2d 196 (1990).

allowed to implement measures that mitigate the associated risk, without reducing its current authorized ROE. It is unreasonable and counterproductive for the Commission's first response to a utility's proposal to implement Water Action Plan priorities to be effectively punitive in nature.

Third, the PD misinterprets a long line of past Commission decisions that have recognized that adoption of a revenue adjustment mechanism may reduce equity risk but have *not* imposed an explicit ROE reduction on that account. The PD is inconsistent with these past decisions in imposing an ROE reduction based solely on the prospective adoption of a WRAM and/or an MCBA.

Finally, the PD adopts an ROE adjustment without even knowing the specific form of a WRAM and/or an MCBA – or the specific conservation rate design – that may be adopted for California American. Without knowledge of these “details,” it is premature to be adopting such an adjustment – even if such an adjustment were warranted on analytical or policy grounds, which it is not.

As CWA will show, the issue of whether ROE should be adjusted upon the adoption of a WRAM already is pending consideration, on an industry-wide basis, in the Water Conservation OII. The current PD should not preempt determination of that issue. The proper venue for considering levels of rate of return and ROE will be the company-specific applications in the new, consolidated Cost of Capital proceedings for which the Commission has provided in the just-completed Class A water utilities' Rate Case Plan, adopted May 24, 2007, in D.07-05-062. The new Cost of Capital proceedings will review each company's ROE in the context of *all* the changes implemented pursuant to the Water Conservation OII.

**A. The PD Misunderstands the Implications of the Commission's Past Decisions Authorizing Revenue Adjustment Mechanisms.**

The PD misreads important aspects of the Commission's decisions authorizing revenue adjustment mechanisms and setting ROEs in the context of those mechanisms. CWA will review those decisions in detail in order to set the record straight.

As noted above, ALJ Walwyn finds that the Commission "has consistently held that the adoption of revenue adjustment mechanisms . . . reduces business risk" and, in implementing these mechanisms has "explicitly reflected this risk reduction in each utility's adopted ROE." PD, at 34. The first part of this finding is factual, but the latter part is not.

No gas or electric case has been identified in which the Commission has identified an explicit ROE adjustment based on the adoption or maintenance of a revenue adjustment mechanism. In fact, in each of the energy utility cases on which ALJ Walwyn relies, ROE was trending upward, not down, and the adoption of a revenue adjustment mechanism was simply one consideration mentioned among a variety of other factors; it never was assigned a quantitative weight or effect.

The first relevant decision was the Commission's 1978 order establishing a supply adjustment mechanism ("SAM") to provide natural gas utilities the opportunity to recover the test year level of gas margin in a period of skyrocketing energy costs and scarcity of fossil fuels. *See*, D.88835, 1978 Cal. PUC Lexis 62; 84 CPUC 5, adopted May 16, 1978. In that decision, the Commission recognized a linkage between a SAM and the previously adopted inverted block rate structure, which had substantially *increased* gas utilities' business risk. The Commission viewed the SAM as "a logical concomitant of our policy of inverted rates," recognizing that

supply (or more correctly, sales) volume has become at once (1) a factor of extraordinary impact on the gas margin as well as (2) an element of ratemaking that cannot be quantitatively predicted with the precision required to assure that a utility neither grossly exceeds nor falls far short of its

authorized gas margin. In short, like the purchased *cost* of gas, supply fluctuation must be accorded special treatment between general rate proceedings.

1978 Cal. PUC Lexis 62, at \*12 (emphasis in original).

The Commission expressly rejected the argument that “adoption of a SAM will constitute a step in the direction of a guaranteed rate of return,” observing instead,

a SAM will merely insure that gas utilities achieve the gas margin last found necessary and *limit* the utility to that margin. Utility expenses *other* than the purchased cost of gas can and will change between general rate proceedings and those changes will determine whether the gas margin maintained by a SAM will actually produce a rate of return that meets or exceeds the utility's authorized rate of return. . . . A SAM will thus not guarantee a rate of return but only insure that a utility's exceeding or failing to meet that return will not be the result of extraordinary and unpredictable fluctuations in sales or supply.

*Id.* at \*13-14 (emphasis in original).

In approving implementation of a SAM by California's gas utilities, the Commission recognized that adopting a SAM would reduce risk to the utility shareholder, but the Commission made no attempt to quantify that reduction. Instead, the Commission deferred the issue as one to be considered “in setting a reasonable rate of return in future general rate proceedings as well as those currently pending before the Commission.” *Id.* at \*14.

In that next round of GRCs, the Commission kept the authorization of SAMs in mind, but still did not assign any specific value to them. In *Pacific Gas and Electric Co.*, D.89316, 1978 Cal. PUC Lexis 973; 84 CPUC 248, adopted September 6, 1978, the Commission stated,

In determining a fair return on common equity for these proceedings, we have considered the impact on risk derived from our adoption of Rate Stabilization and Energy Cost Adjustment Clause (ECAC) procedures for PG&E's electric department and the SAM and Purchased Gas Cost Adjustment Clause (PGA) for the gas department. We have also considered the fact that the Regulatory Lag Plan (applied to PG&E for the first time in these proceedings) worked extremely well.

These measures are designed to better allow PG&E to maintain a reasonably constant cash flow between general rate proceedings. These measures,

however, must be viewed in the context of recent increases in inflation and upward trends in interest rates. But for these measures, it is likely that a higher return on common equity might be warranted to insure the financial health of the utility. Although, as mentioned, our innovative ratemaking measures impact risk downward, we do not find that in the balance (weighed against rising debt cost) a reduction in allowed return on equity is warranted.

*Id.* at \*27-28. Accordingly, the Commission maintained PG&E's authorized ROE at 12.83%.

In its first review of rates for Southwest Gas Co. (a company comparable in size to several Class A water utilities) following allowance of a SAM, the Commission noted staff's recommendation that ROE be reduced from 13.3% to 12.97%, based on several considerations including the allowance of a SAM. *Southwest Gas Co.*, D.89706, 1978 Cal. PUC Lexis 1510, at \*10, 84 CPUC 634, adopted December 12, 1978. Having "carefully considered all of the above-listed factors (including the effect of SAM)," the Commission concluded that the last authorized return on equity of 13.3% should be maintained. The Commission explained this determination as follows:

Our adoption of a 13.3 percent return on equity is made in recognition that, as the staff points out, there are factors since we originally adopted that return (in SW's last rate proceeding) which very arguably reduce risk. However, we stress, on the other hand, that the 13.3 percent rate on equity authorized herein is made with recognition that the next test year we will use to set rates for SW will be 1981. . . . Accordingly, we are authorizing the rates herein (through adoption of a results of operation and return on equity rate base) conditional upon employing 1981 as the next earliest test year for establishing SW's base rates (and issuing a rate decision prior to the beginning of such test year).

. . . Although SAM does not guarantee a gas utility will realize its authorized rate of return, it minimizes the impact of the most volatile contingencies facing a gas utility, gas supply available for sale, and less use per customer due to conservation efforts.

The factors that may operate between general rate proceedings in such a manner as to preclude SW's realizing its authorized return on equity are expenditures subject to its management's review and discretion. The innovative ratemaking procedures we have adopted, and continue to explore, have clearly paved the way to going a minimum of two years between general rate increases.

*Id.* at \*12-14; *see also*, *Southern California Gas Co.*, D.89710, 1978 Cal. PUC Lexis 1506, \*38-40; 84 CPUC 657, adopted December 12, 1978 (granting a 13.49% ROE with similar language). Thus, the Commission took the allowance of a SAM into account along with the effect of a two-year GRC cycle, and concluded that ROEs should be maintained or increased.

This string of gas utility decisions implementing the SAM and setting ROEs in the context of the SAM among other factors has clear implications for water utilities. If a two-year GRC cycle for Southwest Gas and SoCal Gas cancelled out the risk mitigation of a SAM, then the ever more rigorous three-year GRC cycle to which Class A water utilities are subject may justify the same response to the WRAM. More generally, it is clear that imposing a quantified, “explicit” ROE reduction based on the allowance of a WRAM, but without comparable ROE increases based on countervailing factors, would be inappropriate and cannot be justified by relevant precedent.

The next round of energy utility GRCs featured the Commission’s approval of a similar revenue adjustment mechanism for electric rates, called the Electric Revenue Adjustment Mechanism (“ERAM”). As will be evident, these cases provide no better support for the explicit ROE reduction mandated by the PD.

The Commission explained the value of the ERAM in a PG&E decision:

It will reduce the time devoted to the issue of appropriate sales estimate levels to be used for ratemaking. It is especially difficult in this period to make accurate sales estimates because of the state of the economy and the inability to accurately quantify the effects of conservation which we are expecting our utilities to promote even more vigorously in the future. Furthermore, the adoption of an ERAM at this time will eliminate any disincentives PG&E may have to promote vigorous conservation measures and also be fair to ratepayers in assuring that PG&E receives no more or no less than the level of revenues intended to be earned.

*Pacific Gas and Electric Co.*, D.93887, 1981 Cal. PUC Lexis 1279, \*86, 7 CPUC2d 349, adopted December 30, 1981. In the same decision, the Commission granted PG&E its highest

ever ROE of 16.0%, based on a number of financial considerations, while observing – without any quantification – that “additional cash flow resulting from the Tax Act as well as the revenue stability from the Energy Revenue Adjustment Mechanism (ERAM) adopted herein should reduce PG&E's risk and thus the size of the return.” *Id.* at \*14.<sup>3</sup>

In a decision issued the same day, approving an ERAM for SDG&E, the Commission addressed the risk implications as follows:

Related to the question of risk reduction for the utility, we note that this decision provides for a revenue adjustment mechanism which protects SDG&E from any reduction in electric sales below the adopted figures. Conversely, if sales are above the adopted figures, the ratepayers will receive a refund. This mechanism is described in the results of operations section. We might mention there is a similar mechanism already in place for gas sales and this has insulated SDG&E from the effects of reduction in gas sales.

*San Diego Gas & Electric Co.*, D.93892, 1981 Cal. PUC Lexis 1284; 7 CPUC2d 584, adopted December 30, 1981.

In the SDG&E decision, the Commission did not try to quantify the risk reduction benefits of SAM and ERAM. Rather, the Commission’s attention was directed to the viability of SDG&E as an investment choice. The Commission observed that “since all utilities have to compete in the same marketplace as industrials, the rates of return must adequately reflect market conditions.” Accordingly, the Commission adopted a historically high 16.25% return on common equity as reasonable for SDG&E. *Id.* at \*39-40.

The last in this series of decisions on which the PD relies was *Southern California Edison Co.*, D.82-12-055, 1982 Cal. PUC LEXIS 1209, 10 CPUC2d 155, adopted December 13, 1982. In that decision, the Commission noted several parties’ opposition to the ERAM concept

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<sup>3</sup> Elsewhere in the decision, the Commission observed that “the Tax Act has legislatively provided PG&E with a substantial increase in cash flow. Our adopted rate of return on rate base and return on common equity gives consideration to this increase in cash flow as well as the adoption of ERAM and attrition adjustment procedures.” *Id.* at \*82. The PD, at 35, quotes only the second sentence above, thereby obscuring the fact that the Commission considered PG&E’s cash flow benefits under the Tax Reform Act of 1981 along with ERAM and a new attrition allowance, and still *increased* PG&E’s ROE to a level never seen before or since that date.

on the basis that it would detract from conservation efforts and shift a stockholder's risk to the ratepayers, but expressed the opinion that “any such effects are more than offset by the advantages that accrue to the ratepayer and stockholder alike.” *Id.* at \*30-31.

In addressing ROE in this Edison case, the Commission expressed the following considerations:

The determination of a reasonable return on equity is necessarily a matter of judgment and cannot be reduced to a fixed formula. Each case must be decided after considering many variables, such as the cost of money, the capital structure of the utility in comparison with similar utilities, and interest coverage ratios. In addition, risk factors specific to the utility must be considered. We have provided for an electric revenue adjustment mechanism. This mechanism reduces the risk to the company that its earnings may be eroded by a reduction in electric sales below the adopted sales levels. We have also provided an attrition allowance which will provide Edison a reasonable opportunity to earn the authorized rate of return in attrition year 1984.

We take cognizance of the decline in interest rates which has occurred since the submission of this proceeding. There is now little indication that interest rates will approach levels during 1983 which were forecasted during the hearing process. In light of this factor, Edison's cost of financing should be lower than Edison originally anticipated.

After weighing all of the above factors, we find that a return on common equity of 16% is just and reasonable.

*Id.* at \*233-34. In other words, having approved an ERAM and an attrition allowance for Edison and observing a decline in interest rates, the Commission still granted Edison a 16.0% ROE, the highest ever authorized for that utility.<sup>4</sup>

ALJ Walwyn concedes that the most recent energy cases in which the Commission authorized revenue adjustment mechanisms – during the electric power crisis of 2000 to 2002 – do not support her thesis that automatic ROE adjustments must follow. The PD notes that

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<sup>4</sup> In presenting DRA's reference to the Edison ERAM decision, the PD makes the same error as DRA in providing only a partial quote of the Commission's assessment that ERAM provides the utility “a better opportunity to earn its authorized rate of return” but also protects the ratepayer by insuring “that the utility retains no more than the authorized amount of base rate revenue.” Both DRA and the PD misleadingly omit the latter portion of the relevant decision excerpt. *Compare*, PD, at 33, with D.82-12-055, at 1.



revenue balancing accounts were reinstituted at that time pursuant to the Legislature's enactment of ABX1-29. PD, at 34 n. 38. However, there was no provision either in that statute (codified as Public Utilities Code §739.10) or in the Commission's implementing decision, D.02-04-055, imposing any impediment upon the Commission's power to adjust electric utility ROEs in response to the reestablishment of ERAM accounts. The Commission simply chose not to do so.

Finally, the PD looks to the Commission's authorization of sales loss memorandum accounts and revenue adjustment mechanisms for water utilities, in the context of the 1990 *Drought OII* decision, D.90-08-055, and the subsequent imposition of a 0.2% ROE reduction as precedent for imposing an explicit percentage reduction in ROE. *See*, PD, at 37-38, *citing* D.91-10-042. In this context, the PD asserts that California Water Service Co. ("CWS") calculated a 1.23% reduction in ROE for purposes of interim recovery and a 0.51% factor for a permanent ROE reduction and "initially offered" to accept such a "risk adjustment." PD, at 38, 40. This partial rendition of the facts is seriously misleading.

What the PD overlooks is that CWS submitted testimony in the *Drought OII* contending that "it is inappropriate to single out the narrow issue of reduced risk associated with the recovery of drought-related lost revenues" in the assessment of financial risks for water utilities. Testimony of CWS, Phase II Risk Assessment, I.89-03-055, dated April 29, 1991, at 1. CWS also opposed any ROE adjustment for reduced risk due to recovery of lost revenue because the utility's previously authorized return did not contain any specific allowance for such risk. *Id.* at 3. The 1.23% and 0.51% calculations CWS offered in that case were quantifications of drought-related loss of ROE due to water rationing. Contrary to the PD's inference, CWS *opposed* reflecting these calculations in its authorized ROE. *Id.* at 5-6.

These are the cases on which the PD relies for its finding that, in implementing revenue adjustment mechanisms, the Commission has "explicitly" reflected a reduced business

risk in each utility's adopted ROE. PD, at 34. These are the cases that the PD sees as calling for a downward adjustment to ROE to reflect reduced business risk if a WRAM is adopted for California American in the next phase of the current GRC. *Id.* at 38. However, as must be clear from the more thorough references provided above, in only one of these cases – the *Drought OII* – did the Commission identify a specific adjustment to ROE (just 0.2%) based on implementation of a revenue adjustment mechanism – and in all other cases the Commission has considered the SAM or ERAM only as *one factor among many* that is relevant to the determination of ROE.

**B. The PD Errs in Considering the Impact of a WRAM on Cost of Equity in Isolation From Conservation Efforts, Including Conservation Rate Design.**

Authorization and implementation of a WRAM does not occur in isolation. To the contrary, the Commission has encouraged water utilities to request WRAMs in the general context of the Commission's increased emphasis on promoting water and energy conservation and in the specific context of the Commission's promotion of conservation-oriented rate design. *See, Water Conservation OII, supra*, at 3-6.

It is unreasonable to impose an ROE adjustment reflecting the increased revenue stability that a WRAM may offer without also considering the volatility of revenues, reduction in sales, and increase in operating costs that may result from expanded conservation programs and conservation-oriented rates. The evidentiary record, as developed by both California American and DRA, supports that conclusion.

California American's WRAM proposal would provide for recovery of all the utility's authorized fixed costs through a monthly service charge and a quantity rate protected by a WRAM account. Exh. 7 (Stephenson/CAW), at 11. The WRAM account would track the difference between full recovery of authorized fixed costs and the amount actually recovered and

would provide for later recovery of that difference. *Id.* at 12. California American's proposed MCBA is intended to track the difference between per-unit purchased water and power costs embedded in rates and those costs actually incurred by the utility. *Id.* at 34.

California American urged approval of these tracking proposals as means of reducing its long-term exposure to increased financial risk as a direct result of its corporate commitment to promoting conservation. Exh. 3 (Exh. A to App.), ch. 13, section 1, at 2. In practice, these mechanisms will tend to moderate variations between projected and actual revenues and costs to the benefit of both the utilities and their customers. Some variable and fixed costs will not be covered by either mechanism, so reduced consumption will continue to put the utility's cost recovery at risk to some extent.

DRA's witness likewise recognized that one purpose of a RAM is "to counter the perceived disincentive that utilities have to promote conservation," because successful conservation programs result in reduced sales that would lower revenues and earnings absent a RAM. Supplement to DRA Cost of Capital Report, dated June 22, 2006, at 3. Without a revenue adjustment mechanism, achieving conservation levels that exceed rate case projections will make it far more difficult for the utility to earn the return on its investment that the Commission has found to be fair and reasonable. In the face of the Water Action Plan's mandate to achieve conservation, this presents the water utility with a stark and serious financial risk.

It is unreasonable to impose a downward ROE adjustment based on adoption of a WRAM while not considering the increased risk imposed on the utility by a conservation-oriented rate design. This is especially true in the circumstances of the present California American GRC, where proposals for a reformed rate design and a WRAM are to be considered and potentially adopted concurrently in a further phase of this ongoing proceeding.

**C. The PD Errs in Magnifying the ROE Reduction Based on the Assumption That Both a WRAM and an MCBA Will Be Authorized in Their Present Forms.**

The PD is inconsistent and ambiguous in its consideration of the MCBA. At one point, the PD appears to recognize that different versions of an MCBA may have different impacts on risk and that the version of an MCBA that may be adopted in Phase 2 of the California American case is as yet unknown. The PD therefore claims to have based its ROE adjustment “primarily on the WRAM.” PD, at 40. The PD nonetheless finds that the WRAM and MCBA together offer “substantial protection from weather and conservation uncertainties” – providing a reduction in business risk “much broader than the memorandum account protection we adopted in the Drought OII.” PD, at 41. The 0.50% ROE reduction reflects this allegedly “broader” reduction in risk. *Id.* at 41.

It is not just the MCBA that is not fully defined. Both the MCBA and the WRAM, as proposed by California American and as criticized by DRA, are potentially subject to reevaluation and reworking in the upcoming Phase 2 of this California American GRC. Substantially different versions of both sorts of mechanisms have been proposed by other utilities in other applications. The place for evaluating the implications of all these mechanisms for the utilities’ rates of return is the Water Conservation proceeding, I. 07-01-022.

The PD itself recognizes the need to develop a “track record of performance under the new mechanisms,” observing that the Commission “may revisit the level of the ROE adjustment in later GRCs, when we have a track record of performance under the new mechanisms and also can look at the performance of the six comparable water companies we used in the DCF analysis here, especially if those companies do not have WRAMs and MCBAs.” PD, at 3 n. 3. The Commission dealt with the ROE issue in similar terms when it authorized the SAM back in 1978, but at that time the Commission wisely deferred dictating an immediate adjustment to any

utility's ROE. *See*, D.88835, *supra*, 1978 Cal. PUC Lexis 62, \*14. The Commission should do the same today.

### III.

#### **THE COMMISSION SHOULD CONSIDER THE RELEVANCE OF CONSERVATION MEASURES, INCLUDING WRAM AND RATE DESIGN CHANGES, TO ROE IN OTHER PROCEEDINGS**

The Commission's Water Action Plan, adopted December 15, 2005, and the more recent Water Conservation OII, have presented water utilities, their regulators, and other interested parties with a complex array of interrelated tasks. The Water Conservation proceeding is addressing several water utilities' differing proposals for conservation rate design and for revenue adjustment mechanisms such as California American's WRAM. That proceeding is the proper venue to consider the combined effects of the individual utilities' particular conservation initiatives and revenue adjustment mechanisms on their financial risk and on generic ROE policy.

In the Water Conservation OII, the Commission specifically recognized the nexus between conservation rate design and WRAM as they may affect the utilities' required ROE – and posing the following question: *Should the utilities' required return on equity be adjusted if a WRAM is adopted?* – as one of the issues presented by implementation of increasing block rates. I.07-01-022, *supra*, at 8.

This is an issue the Commission has assigned for consideration in the Water Conservation proceeding. Commissioner Bohn, the Assigned Commissioner for that investigation, has directed that conservation rate design issues for California American, presented in California American's recently filed GRC proceedings, A.07-01-036 through A.07-01-039, should be coordinated with I.07-01-022. *See*, Assigned Commissioner's Ruling and Scoping Memo, issued March 8, 2007, in I.07-01-022, at 7. It makes no sense for the

Commission to prejudge the answer to the Conservation OII's question in a GRC decision that precedes even knowing the specific form of WRAM (or MCBA) that may eventually be approved for California American.

The issue presented in the Water Conservation OII is a general policy issue, posing the question whether adoption of a WRAM warrants adjusting the utilities' ROE. If the Commission's answer to that policy question turns out to be "yes," then the proper venue for considering the amount of any ROE adjustment will be the company-specific applications in the consolidated Cost of Capital proceedings, set for 2008 and 2009, and associated with the water utilities' rate case plan, as recently modified. *See, Rulemaking to Consider Revisions to the General Rate Case Plan For Class A Water Companies*, D.07-05-062, adopted May 24, 2007. It is appropriate that these Cost of Capital proceedings review each utility's ROE in the context of *all* the changes being implemented for that utility pursuant to the Water Conservation OII. This is just as true for California American as for any of the other Class A water utilities.

As indicated above, the utilities' Cost of Capital proceedings appear to be the best venue for addressing the implications for water utilities' ROEs of the adoption of conservation promoting measures in the Water Conservation proceeding. The Commission need not finally resolve that procedural issue at this time. All that is needed for now is to revise the pending PD to defer resolution this issue in the current California American GRC.

IV.  
**CONCLUSION**

For all the reasons presented above, California Water Association respectfully urges the Commission to modify the Proposed Decision of ALJ Walwyn by eliminating the pre-determination that a downward Return on Equity adjustment of a particular amount should be made in the event that a WRAM and an MCBA are adopted for California American in the next phase of this proceeding. Accordingly, CWA respectfully proposes a substitute form of Finding of Fact 17 and a substitute form of Conclusion of Law 7 and further proposes the elimination of Ordering Paragraph 5 and the renumbering of Ordering Paragraphs 6 and 7, all as presented in detail in the attached Appendix A to these comments.

Respectfully submitted,

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Attorneys for CALIFORNIA WATER ASSOCIATION

May 29, 2007

## APPENDIX A

### PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

#### Findings of Fact

17. The adoption of a WRAM and / or MCBA in Phase 2, in conjunction with conservation-oriented rate design changes, ~~might affect is a significant element of and consideration in Cal-Am's business risk profile and that effect element would is be one of~~ many factors relevant to a future determination of ROE for Cal-Am.

#### Conclusions of Law

7. Our case law for energy and water utilities reflects that the Commission has consistently held that the ~~implementation consideration~~ of a revenue adjustment mechanism is relevant to the determination of ROE ~~in future Cost of Capital proceedings.~~

#### ORDER

5. ...

6. ...



## CERTIFICATE OF SERVICE

I, Jeannie Wong, hereby certify that on this date I will serve the foregoing  
MOTION OF CALIFORNIA WATER ASSOCIATION FOR PARTY STATUS by electronic  
mail, on the following parties to A.06-01-005:

**By electronic mail:**

tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org;  
creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com;  
dalderson@rwglaw.com; ndw@cpuc.ca.gov; Ldolqueist@steefel.com; ldolqueist@steefel.com;  
dstephens@amwater.com; rball@cao.lacounty.gov; sdlee3@pacbell.net; jmarkman@rwglaw.com;  
Pinkie.L.Nichols@KP.Org; jvasquez@cityofbradbury.org; lweiss@steefel.com; demorse@omsoft.com;  
darlene.clark@amwater.com; Martina@akwater.com; mrx@cpuc.ca.gov; cmw@cpuc.ca.gov;  
des@cpuc.ca.gov; dsb@cpuc.ca.gov; flc@cpuc.ca.gov; llk@cpuc.ca.gov; mkb@cpuc.ca.gov;  
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**By hand delivery:**

Hon. Christine M. Walwyn  
Administrative Law Judge  
California Public Utilities Commission  
505 Van Ness Avenue, Room 5008  
San Francisco, CA 94102-3214

Executed this 29th day of May, 2007 in San Francisco, California.

/S/ JEANNIE WONG

Jeannie Wong

## Dolqueist, Lori Anne

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**From:** Weiss, Lenard  
**Sent:** Wednesday, May 30, 2007 2:44 PM  
**To:** 'tjs@cpuc.ca.gov'; 'jww@cpuc.ca.gov'  
**Cc:** 'dsteph@amwater.com'; Dolqueist, Lori Anne; Weiss, Lenard  
**Subject:** FW: Courtesy E-mail Notification in I.07-01-022, ALJ Grau's Ruling

**Attachments:** 68471.url



68471.url (165 B)

Here is ALJ Grau's recent Order of consolidation in the Water Conservation OII

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-----Original Message-----

**From:** Tom, Joyce [mailto:jt2@cpuc.ca.gov]  
**Sent:** Tuesday, May 29, 2007 3:21 PM  
**To:** Kendall.MacVey@BBKlaw.com; Dolqueist, Lori Anne; Patrick, Bertram D.; bill@jbsenergy.com; bobkelly@bobkelly.com; Bondonno, Maria L.; broeder@greatoakswater.com; charak@nclc.org; charles.forst@360.net; cmailloux@turn.org; dadelloso@sgvwater.com; danielle.burt@bingham.com; darlene.clark@amwater.com; debbie@ejcw.org; debershoff@fulbright.com; demorse@omsoft.com; Marquez, David; doug@parkwater.com; Brooks, Diana; dsteph@amwater.com; ed@parkwater.com; enriqueg@lif.org; Curry, Fred L.; fyanney@fulbright.com; Park, Jaeyeon; jeff@jbsenergy.com; jguzman@nossaman.com; jhawks\_cwa@comcast.net; Grau, Janice L.; jlkiddoo@swidlaw.com; john.greive@lightyear.net; Steingass, Joyce; Bruno, Kenneth; kswitzer@gswater.com; leigh@parkwater.com; lex@consumercal.org; Krannawitter, Laura L.; lmcghee@calwater.com; luhintz2@verizon.net; Weiss, Lenard; marcel@turn.org; mcegelski@firstcomm.com; McCrary, Monica L.; mmattes@nossaman.com; Poirier, Marcelo; mvander@pcl.org; Wales, Natalie; nsuetake@turn.org; owein@nclcdc.org; palle\_jensen@sjwater.com; Hoggland, Patrick E.; pucservice@dralegal.org; rdiprimio@valencia.com; rkmoore@gswater.com; DeAngelis, Regina; sferraro@calwater.com; Wilson, Sean; Olea, Tatiana; tjryan@sgvwater.com; Howard, Ted  
**Subject:** Courtesy E-mail Notification in I.07-01-022, ALJ Grau's Ruling

<<68471.url>> As a courtesy, the Commission notifies you that the text of ALJ Grau's Ruling Consolidating Application of San Jose Water company, Modifying Schedule and Addressing Phase I Hearings was made available at <http://www.cpuc.ca.gov/EFIL/RULINGS/68471.htm> on May 29, 2007. A Notice of Availability has been served by mail on all persons on the service list.

In case of problems with this e-mail or the internet link, please contact Joyce Tom at jt2@cpuc.ca.gov, telephone #(415)703-5332.

JLG/jt2 5/29/2007



**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**FILED**  
65-29-07  
02:42 PM

Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities.

Investigation 07-01-022  
(Filed January 11, 2007)

In the Matter of the Application of Golden State Water Company (U 133 E) for Authority to Implement Changes in Ratesetting Mechanisms and Reallocation of Rates.

Application 06-09-006  
(Filed September 6, 2006)

Application of California Water Service Company (U 60 W), a California Corporation, requesting an order from the California Public Utilities Commission Authorizing Applicant to Establish a Water Revenue Balancing Account, a Conservation Memorandum Account, and Implement Increasing Block Rates.

Application 06-10-026  
(Filed October 23, 2006)

Application of Park Water Company (U 314 W) for Authority to Implement a Water Revenue Adjustment Mechanism, Increasing Block Rate Design and a Conservation Memorandum Account.

Application 06-11-009  
(Filed November 20, 2006)

Application of Suburban Water Systems (U 339 W) for Authorization to Implement a Low Income Assistance Program, an Increasing Block Rate Design, and a Water Revenue Adjustment Mechanism.

Application 06-11-010  
(Filed November 22, 2006)

Application of San Jose Water Company (U 168 W) for an Order Approving its Proposal to Implement the Objectives of the Water Action Plan.

Application 07-03-019  
(Filed March 19, 2007)

**ADMINISTRATIVE LAW JUDGE'S RULING CONSOLIDATING APPLICATION  
OF SAN JOSE WATER COMPANY, MODIFYING SCHEDULE AND  
ADDRESSING PHASE I HEARINGS**

This ruling consolidates the Water Action Plan application of San Jose Water Company (San Jose), establishes Phases 1A and 1B to consider rate-related conservation measures, sets hearings for the return on equity adjustment in Phase 1B and grants with modification the motion of The Utility Reform Network (TURN) and California Water Service Company (CalWater) to modify the schedule.

**Consolidation of San Jose's Application**

This Order Instituting Investigation (OII) was opened to address policies to achieve the Commission's conservation objectives for Class A water utilities and consolidated four applications to adopt increasing block rate designs, water revenue adjustment mechanisms (WRAMs), and conservation memorandum accounts. In the OII, the Commission stated subsequent applications raising similar issues might be consolidated. San Jose filed Application 07-03-019 to request increasing block rates for residential consumers, a WRAM, a full cost balancing account, and the expansion of its existing water quality memorandum account in order to implement the Commission's Water Action Plan.

The Division of Ratepayer Advocates (DRA) filed a protest to San Jose's application and requested consolidation of the application with this OII. San Jose is a respondent to this OII, and consolidation of its application is the most efficient means of addressing the conservation rate design proposals it raises. San Jose's proposal should be addressed in the rate-related conservation phase of this proceeding.

### **Phases 1A and 1B**

The March 8, 2007 scoping memo divided this proceeding into two phases. Phase 1 considers rate-related conservation measures and Phase 2 will consider non-rate design conservation measures. Settlement agreements have been filed for CalWater and Suburban Water Systems' (Suburban) conservation rate design proposals.<sup>1</sup> Settlement negotiations continue for Park Water Company's (Park) proposals. TURN and CalWater have requested the opportunity to file an amended settlement agreement.

The conservation rate design proposals for CalWater, Suburban and Park will be evaluated in Phase 1A with a partially modified schedule. The schedule sets a new date for filing any full or partial settlement agreement on Park's rate-related conservation issues.<sup>2</sup> Phase 1A hearings will address contested issues raised by the parties on the CalWater and Suburban settlement agreements. Testimony also will address either Park's application or contested issues on any Park settlement agreement.

Phase 1B will consider San Jose's application and Golden State Water Company's (GSWC) amended application. The Phase 1B schedule is set forth below; a second round of testimony and hearings is scheduled to permit the parties to undertake settlement negotiations in advance of those deadlines. Phase 1B also will address whether CalWater, Suburban, Park, GSWC or

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<sup>1</sup> The comment schedule for the CalWater/ DRA settlement was taken off calendar by e-mail ruling on May 18, 2007.

<sup>2</sup> Should the parties reach a settlement agreement after the filing deadline, they must either file an all-party settlement agreement or get the other parties' concurrence to adhere to the schedule for filing comments.

San Jose's return on equity should be adjusted if a WRAM is adopted. We defer hearings on the adjustment to Phase 1B, because it permits one round of hearings on the adjustment and it efficiently allocates resources in light of the need for more time to finalize settlement negotiations.

In addressing whether a return on equity adjustment is warranted, the parties should address the following issues in their testimony:

- What measures of risk should be considered in setting a return on equity and in determining whether these risks have been altered when a WRAM is applied: operating (e.g. fixed assets relative to earnings; earnings variance), financial (e.g. level of debt), and business risks (e.g. economies of scale; water demand and supply; elasticity of demand)? Other types of risk?
- What impact(s) could adopting a return on equity adjustment have on the Commission's conservation objectives for Class A water utilities?
- Should any return on equity adjustment be made if the adopted WRAM recovers all fixed costs affected by the proposed conservation rate design? Should the Commission order a return on equity adjustment if all fixed costs are not recovered through the WRAM?
- Should the adoption of a modified cost balancing account affect whether a return on equity adjustment is adopted?
- Should company-specific factors be considered in weighing whether a return on equity adjustment should be adopted? What company-specific factors should be considered? What methods (e.g. Discounted Cash Flow (DCF); Capital Asset Pricing Model (CAPM); Risk Premium; Multiple Regression; other) for estimating any potential impact of a WRAM on the required return on equity should be utilized *prior* to instituting the WRAM?
- What methods (e.g. DCF; CAPM; Risk Premium; Multiple Regression; other) for estimating any potential impact of a WRAM on the required, and achieved, return on equity should be utilized *after* instituting the WRAM?
- How much historical data (e.g. 1 year? 3 years? 5 years?) would be required for an accurate estimate of this potential impact?

- Should publicly-traded companies with similar operating, financial, and business risks be utilized for these calculations?
- Is the experience of non-water utilities germane?
- Should any return on equity adjustment be interim subject to reconsideration in the separate cost of capital proceeding?

This revision to the Phase 1 schedule anticipates a proposed decision will issue at the conclusion of Phase 1A. If the proposed WRAMs are adopted in that decision, they will not be amortized pending consideration of whether a return on equity adjustment is required. The amortization would be trued up to account for any delay.

### **Motion to Modify Schedule**

CalWater and TURN filed a motion to modify the schedule in order to permit negotiations to resolve TURN's objections to the CalWater/DRA settlement agreement. DRA supports the motion and other parties interested in the settlement's WRAM and rate design issues do not object to the extension. Since the hearings will proceed as planned if an amended settlement agreement is filed, the motion is granted. The proposed hearing schedule is modified as set forth below.

### **Timetable**

Pursuant to the OII, the undersigned assigned Commissioner and/or the ALJ may revise the schedule. The schedule is revised as follows:

**Phase 1A: Suburban**

May 23, 2007	Comments on Suburban/DRA settlement agreement
June 7, 2007	Reply comments on Suburban/DRA settlement agreement
June 29, 2007	Settling parties' testimony on Suburban's contested issues
July 20, 2007	Contesting parties' testimony on contested issues for Suburban settlement
July 30-August 3, 2007	Hearings - Commission Court Room, State Office Building, 505 Van Ness Avenue, San Francisco, CA 94102, July 30, 2007, 10:00 a.m., and July 31 - August 3, 2007, 9:30 a.m.
TBD	Briefs
TBD	Mailing of proposed decision, first possible Commission consideration of proposed decision



**Phase 1A: CalWater, Park**

May 30, 2007	Park settlement agreement filed
June 15, 2007	CalWater/DRA amended settlement agreement filed
June 29, 2007	Opening testimony on Park rate-related conservation measures, if no settlement filed. Opening comments on CalWater amended settlement and Park settlement, if settlement filed
July 6, 2007	Reply comments on CalWater amended settlement and Park settlement, if filed
July 13, 2007	Settling parties' testimony on contested issues for CalWater amended settlement and Park settlement, if filed
July 20, 2007	Reply testimony on Park rate-related conservation issues, if no settlement filed. Contesting parties' testimony on contested issues for CalWater amended settlement, and Park settlement, if settlement filed
July 30-August 3, 2007	Hearings - Commission Court Room, State Office Building, 505 Van Ness Avenue, San Francisco, CA 94102, July 30, 2007, 10:00 a.m., and July 31 - August 3, 2007, 9:30 a.m.
TBD	Briefs
TBD	Mailing of proposed decision, first possible Commission consideration of proposed decision

**Phase 1B: GSWC, San Jose, ROE Adjustment**

September 21, 2007	Opening testimony on rate-related conservation measures or settling parties' testimony on contested issues for GSWC and San Jose; opening testimony on return on equity adjustment for CalWater, Suburban, Park, GSWC and San Jose
October 12, 2007	Reply testimony on rate-related conservation issues or contesting parties' testimony on contested issues for GSWC and San Jose; reply testimony on return on equity adjustment for CalWater, Suburban, Park, GSWC and San Jose
October 22-26, 2007	Hearings - Commission Court Room, State Office Building, 505 Van Ness Avenue, San Francisco, CA 94102, October 22, 2007, 10:00 a.m., and October 23 - 26, 2007, 9:30 a.m.
TBD	Briefs
TBD	Mailing of proposed decision, first possible Commission consideration of proposed decision

A Phase 2 schedule will issue in July or August 2007.

Therefore, **IT IS RULED** that:

1. San Jose Water Company's Application 07-03-019 is consolidated with this Order Instituting Investigation.
2. California Water Service Company and The Utility Reform Network's May 16, 2007 Motion to Modify Schedule is granted as set forth herein.

3. The schedule for this proceeding is revised as set forth herein.

Dated May 29, 2007, at San Francisco, California.

/s/ JANICE L. GRAU

Janice L. Grau  
Administrative Law Judge

## Dolqueist, Lori Anne

---

**From:** Weiss, Lenard  
**Sent:** Wednesday, May 30, 2007 2:47 PM  
**To:** 'tjs@cpuc.ca.gov'; 'jjw@cpuc.ca.gov'  
**Cc:** 'dstephen@amwater.com'; Dolqueist, Lori Anne; Weiss, Lenard  
**Subject:** FW: Emailing: Comments of California Water Service Company, California Water Service Company Motion for Party Status

**Attachments:** Comments of California Water Service Company.pdf; California Water Service Company Motion for Party Status.pdf



Comments of California Water S...



California Water Service Compa...

More.

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-----Original Message-----

**From:** Ferraro, Stan [mailto:sferraro@calwater.com]  
**Sent:** Tuesday, May 29, 2007 12:32 PM  
**To:** tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org; creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com; dalderson@rwglaw.com; ndw@cpuc.ca.gov; Dolqueist, Lori Anne; Dolqueist, Lori Anne; dstephen@amwater.com; rball@cao.lacounty.gov; sdlee3@pacbell.net; jmarkman@rwglaw.com; Pinkie.L.Nichols@KP.Org; jvasquez@cityofbradbury.org; Weiss, Lenard; demorse@omsoft.com; darlene.clark@amwater.com; Martina@akwater.com; mrx@cpuc.ca.gov; cmw@cpuc.ca.gov; des@cpuc.ca.gov; dsb@cpuc.ca.gov; flc@cpuc.ca.gov; ilk@cpuc.ca.gov; mkb@cpuc.ca.gov; nyg@cpuc.ca.gov; tfo@cpuc.ca.gov; ywc@cpuc.ca.gov  
**Subject:** Emailing: Comments of California Water Service Company, California Water Service Company Motion for Party Status

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**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California- )  
American Water Company (U 210 W) for an )  
Order Authorizing it to Increase its Rates for )  
Water Service in its Los Angeles District to )  
Increase Revenues by \$2,020,466 or 10.88% in )  
the Year 2007; \$634,659 or 3.08% in the Year 2008; )  
and \$666,422 or 3.14% in the Year 2009. )  
\_\_\_\_\_ )

Application 06-01-005  
(Filed January 9, 2006)

**COMMENTS OF  
CALIFORNIA WATER SERVICE COMPANY  
ON PROPOSED DECISION OF ALJ WALWYN**

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Vice President  
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San Jose, CA 95112  
Tel: (408) 367-8225  
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email: sferraro@calwater.com

May 29, 2007

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California- )  
American Water Company (U 210 W) for an )  
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Increase Revenues by \$2,020,466 or 10.88% in )  
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and \$666,422 or 3.14% in the Year 2009. )  
\_\_\_\_\_ )

Application 06-01-005  
(Filed January 9, 2006)

**COMMENTS OF  
CALIFORNIA WATER SERVICE COMPANY  
ON PROPOSED DECISION OF ALJ WALWYN**

In accordance with Rule 14.3 of the Commission's Rules of Practice and Procedure ("Rules"), California Water Service Company ("Cal Water" or "CWS") hereby submits its comments on the proposed decision of Administrative Law Judge ("ALJ") Walwyn, entitled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)" ("Proposed Decision" or "PD"), which was released for comment on May 7, 2007. Cal Water respectfully submits these comments subject to its concurrently filed motion to become a party to this proceeding, pursuant to Rule 1.4 of the Commission's Rules.

**I.**

**CAL WATER'S INTEREST IN THE PROPOSED DECISION**

As an investor-owned water utility that is subject to regulation by the Commission, Cal Water seeks to promote the adoption of sound water policies by the Commission. Moreover, Cal Water is participating actively in the Commission's ongoing investigation to consider policies to achieve conservation objectives for Class A water utilities, I.07-01-022, in which the

parties and the Commission are actively considering the development of conservation-oriented rate design and the adoption of balancing account procedures, such as a Water Revenue Adjustment Mechanism (“WRAM”), designed to decouple water utility sales from revenue. Among the issues presented in the Commission’s order instituting the water conservation investigation is whether the utilities’, including Cal Water’s, required return on equity should be adjusted if a WRAM is adopted. I.07-01-022, at 9. Additionally, on October 23, 2006, Cal Water filed Application 06-10-026, which was consolidated with I.07-01-022, requesting, among other things, a WRAM.

In the context of the present general rate case (“GRC”) for California-American Water Company (“California American”), California American’s conservation rate design and WRAM proposals have yet to be considered, but the Proposed Decision of ALJ Walwyn includes an assessment of the impact that adoption of a WRAM would have on California American’s business risk and therefore on the appropriate level of California American’s authorized rate of return on equity (“ROE”). The PD would impose a 50 basis point (0.50%) downward adjustment of California American’s ROE, in the event that the Commission adopts a WRAM and a Modified Cost Balancing Account (“MCBA”) for Cal-Am in Phase 2 of the current GRC.

The imposition of an ROE adjustment based on authorization of a WRAM, as the PD proposes in the present GRC, could preempt consideration of and predetermine (or, at a minimum, bias the determination of) that issue on an industry-wide basis, including Cal Water, in the Conservation OII. Since Cal Water is a party to I.07-01-022 and has proposed a WRAM, it has a direct interest in the proposal of the PD to impose a downward adjustment in ROE on California American. Additionally, several references in the PD do not accurately represent Cal



Water's testimony and the position it took in Phase II of the Commission's Drought OII. This is why Cal Water is filing its concurrent motion for party status in this GRC.

## **II.**

### **THE PROPOSED DECISION ERRS IN PREJUDGING THE RETURN ON EQUITY IMPACT OF ADOPTING A WRAM.**

The Proposed Decision defers to Phase 2 of the GRC the determination of rate design and of whether to adopt a WRAM and/or an MCBA. However, in anticipation that the WRAM and MCBA may be adopted, the PD determines that "there should be a concurrent .50% reduction in ROE." PD, at 2-3.

By determining that there should be an adjustment to ROE based on a WRAM that the Commission may or may not adopt is like choosing a wine for dinner without knowing the entrée or even if you will have dinner. In the Conservation OII the issue of sales decoupling mechanisms is being addressed first after which parties will address the issue of whether a ROE adjustment is warranted. Moreover, the Conservation OII is addressing the issue of ROE generically. Therefore, consistent with the process in the Conservation OII the issue of a ROE adjustment in the California American proceeding should be deferred until the Commission adopts a WRAM for California American. Additionally, assuming the Commission will adopt a WRAM the issue of a ROE adjustment should be consolidated with the generic issue for other water utilities.

## **III.**

### **THE PROPOSED DECISION MISREPRESENTS CAL WATER'S TESTIMONY IN I.89-03-005 AND I.90-11-033.**

The PD misrepresents Cal Water's testimony in the Commission's Drought OII. As shown below the PD states that:

In Phase II of the Drought OII, the Commission reviewed and approved each water utility's Water Management Plans and developed the specific risk reduction adjustment to be applied to the memorandum accounts prior to the accounts being approved for recovery. In the evidentiary record, DRA recommended a 0.5% reduction and California Water Service Company (CWS), for the limited purpose of interim recovery, calculated a 1.23% reduction in ROE. For a permanent ROE reduction, CWS factored in all 21 of its districts and added a sales fluctuation analysis for a risk assessment of .51%. We adopted a .2% reduction, finding that since the memorandum account was only authorized for a drought period, and full recovery of a reasonable estimate of drought and conservation sales losses was already guaranteed, any residual lost sales from "normal risks" was likely to be minimal. (emphasis added) (PD p38)

Of note, the record reflects that the largest water utility, CWS, initially offered to accept a risk adjustment of .51% for a permanent mechanism that would apply to all 21 of its districts. (PD p.40)

However, D.91-10-042 states:

Utilities presented evidence to show that the normalized sales level is developed using a 30-year average of rainfall and temperature data, and such data excludes periods of drought. CWS witness Francis S. Ferraro testified that this "normalized weather" produces rates that by design will yield less than normal sales during cool/wet years and more than normal sales during warm/dry years, and that these results average out over time. By limiting memorandum account recovery to the normalized sales level (instead of the higher-than-normal sales that could be expected during a warm/dry year), Ferraro said, the Commission already has denied recovery of non-drought sales. Because above-normal sales are excluded in a drought year, the memorandum account has a built-in reduction in ROE which in CWS's case equates to 70 basis points. (Exhibit 152) (pp. 14 & 15)

Furthermore, D.91-10-042 states:

CWS opposes any ROE adjustment. In seeking interim relief, however, CWS proposed the only other risk reduction formula presented on this record. (emphasis added) (p.16)

Moreover, Cal Water's testimony in I.89-03-005 and I.90-11-033, Exhibit 128, clearly states that it provided a calculation of the financial impact rationing has in 11 districts and on the total company's ROE. As stated in D.91-10-042 and Exhibit 128, Cal Water opposed any ROE reduction. Since Cal Water's testimony in I.89-03-005 and I.90-11-033 provided a calculation of the financial impact of the drought (i.e. rationing in 11 districts) it has no relevance to the business risk related to a WRAM. Cal Water's testimony showing the financial impact of rationing was merely a calculation that equated the loss revenue from rationing to a reduction in ROE. Accordingly, if the Commission authorized recovery of loss revenue due to rationing conditioned upon Cal Water's calculation of a reduction in ROE the two would be totally offsetting and would in no recovery of loss revenues. Clearly, the statement in the PD that Cal Water would accept a 0.51% reduction in ROE misrepresents Cal Water's position in the Drought OII proceeding.

IV.

**CONCLUSION**

For all the reasons presented above, Cal Water respectfully urges the Commission to modify the Proposed Decision of ALJ Walwyn by eliminating the pre-determination that a downward Return on Equity adjustment of 0.50% or any other amount should be made in the event that a WRAM and an MCBA are adopted for California American in the next phase of this proceeding. Accordingly, Cal Water respectfully proposes that Finding of Fact 17, Conclusion of Law 7, and Ordering Paragraph 5 be eliminated from the Proposed Decision.

May 29, 2007

Respectfully submitted,

By /s/ Francis S. Ferraro  
Francis S. Ferraro

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## CERTIFICATE OF SERVICE

I, Francis S. Ferraro, hereby certify that on this date I will serve the foregoing  
COMMENTS OF CALIFORNIA WATER SERVICE COMPANY ON PROPOSED DECISION  
OF ALJ WALWYN by electronic mail, on the following parties to A.06-01-005:

**By electronic mail:**

tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org;  
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**By hand delivery:**

Hon. Christine M. Walwyn  
Administrative Law Judge  
California Public Utilities Commission  
505 Van Ness Avenue, Room 5008  
San Francisco, CA 94102-3214

Executed this 29th day of May, 2007 in San Francisco, California.

/s/ Francis S. Ferraro

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California-  
American Water Company (U 210 W) for an  
Order Authorizing it to Increase its Rates for  
Water Service in its Los Angeles District to  
Increase Revenues by \$2,020,466 or 10.88% in  
the Year 2007; \$634,659 or 3.08% in the Year 2008;  
and \$666,422 or 3.14% in the Year 2009.

---

Application 06-01-005  
(Filed January 9, 2006)

**MOTION OF  
CALIFORNIA WATER SERVICE COMPANY  
FOR PARTY STATUS**

In accordance with Rule 1.4 of the Commission's Rules of Practice and Procedure, California Water Service Company ("Cal Water") hereby submits its Motion for Party Status in the above-captioned proceeding. Cal Water respectfully submits this Motion for purposes of commenting on the proposed decision of Administrative Law Judge ("ALJ") Walwyn ("PD"), entitled "Opinion Adopting the Revenue Requirement for California-American Water Company (Los Angeles District)", which was released for comment on May 7, 2007. A copy of Cal Water's comments on the PD is being filed concurrently with the filing of this Motion.

In support of this Motion for Party Status, Cal Water provides the following information:

Cal Water is an investor-owned water utility regulated by this Commission and one of ten Class A water utilities subject to Commission jurisdiction. On October 23, 2006 Cal Water filed Application (A.) 06-10-026 requesting, among other things, a water revenue adjustment mechanism to decouple sales and revenues. A.06-10-026 was consolidated with I.07-01-022, "Order Instituting Investigation to Consider Policies to Achieve the commission's Conservation

Objectives for Class A Water Utilities,” (OII) and three other Class A water utility applications that request approval of conservation rate designs and revenue decoupling mechanisms.

Accordingly, Cal Water is an active party in I.07-01-022. Among the subjects to be considered in the conservation OII is the relationship between the adoption of a water revenue adjustment mechanism (“WRAM”) for an individual water utility and the utility's return on equity. The PD in this proceeding proposes to determine that relationship for California-American Water Company. Cal Water seeks party status in this proceeding to address whether the relationship between a WRAM and a utility's return on equity should be more appropriately handled in a generic proceeding – such as the conservation OII – or on a case-by-case as the PD proposes to do in this proceeding. Thus, Cal Water's proposed participation in this proceeding is pertinent to issues already before the Commission as a result of the PD's proposals. Moreover, Cal Water requests party status to respond to statements in the PD that do not accurately represent Cal Water's testimony and the position it took in Phase II of the Commission's Drought OII. Cal Water's concurrently filed comments will provide the Commission with a clear and accurate representation of Cal Water's testimony and position.

For all of the foregoing reasons, Cal Water urges the Commission to grant this Motion for Party Status and accept Cal Water's comments on the PD being filed concurrently with this Motion.

DATED: May 29, 2007

Respectfully submitted,

By /s/ Francis S. Ferraro  
Francis S. Ferraro

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## **CERTIFICATE OF SERVICE**

I, Francis S. Ferraro, hereby certify that on this date I will serve the foregoing

**MOTION OF CALIFORNIA WATER SERVICE COMPANY FOR PARTY STATUS** by

electronic mail, on the following parties to A.06-01-005:

**By electronic mail:**

tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org;  
creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com;  
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nyg@cpuc.ca.gov; tfo@cpuc.ca.gov; ywc@cpuc.ca.gov;

**By hand delivery:**

Hon. Christine M. Walwyn  
Administrative Law Judge  
California Public Utilities Commission  
505 Van Ness Avenue, Room 5008  
San Francisco, CA 94102-3214

Executed this 29th day of May, 2007 in San Francisco, California.

/s/ Francis S. Ferraro



**Dolqueist, Lori Anne**

---

**From:** Weiss, Lenard  
**Sent:** Wednesday, May 30, 2007 2:49 PM  
**To:** 'tjs@cpuc.ca.gov'; 'jjw@cpuc.ca.gov'  
**Cc:** 'dstephen@amwater.com'; Dolqueist, Lori Anne; Weiss, Lenard  
**Subject:** FW: A.06-01-005 - Comments of the DRA on Phase One Proposed Decision  
**Attachments:** A.06-01-005 - Comments of the DRA.pdf

And the last one.

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**To:** tkim@rwglaw.com; gkau@cityofinglewood.org; councilofficedistrict2@cityofinglewood.org; creisman@wkrklaw.com; krozell@wkrklaw.com; bmarticorena@rutan.com; uwua@redhabanero.com; dalderson@rwglaw.com; Wales, Natalie; Dolqueist, Lori Anne; Dolqueist, Lori Anne; dstephen@amwater.com; rball@cao.lacounty.gov; sdlee3@pacbell.net; jmarkman@rwglaw.com; Pinkie.L.Nichols@KP.Org; jvasquez@cityofbradbury.org; Weiss, Lenard; demorse@omsoft.com; darlene.clark@amwater.com; Martina@akwater.com; Nixon, Marcus; Walwyn, Christine M.; Sanchez, Danilo E.; Brooks, Diana; Curry, Fred L.; Krannawitter, Laura L.; Bumgardner, Mark; Gatchalian, Nora Y.; Olea, Tatiana; Chan, Yoke W.  
**Cc:** Kinosian, Robert; Walker, Cynthia; WebDRA  
**Subject:** A.06-01-005 - Comments of the DRA on Phase One Proposed Decision

Electronic Format: PDF

Serving Party: DRA

In case of problems with the e-mail or the attached document, contact the following person:

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Fax #: (415) 703-2262

6/20/2007

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Note: to update your e-mail address, please follow the procedure in Rule 1.9(e) of the Commission's Rules of Practice and Procedure.

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Application of  
CALIFORNIA-AMERICAN WATER  
SERVICE COMPANY (U 210 W) for an  
order authorizing it to increase its rates for  
water service in its Los Angeles District to  
increase revenues by \$2,020,466 or 10.88% in  
the year 2007; \$634,659 or 3.08% in the year  
2008; and \$666,422 or 3.14% in the year  
2009.

A.06-01-005  
(Filed January 9, 2006)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES  
ON PHASE ONE PROPOSED DECISION**

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May 29, 2007

Attorney for  
DIVISION OF RATEPAYER ADVOCATES

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A.06-01-005  
(Filed January 9, 2006)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES  
ON PHASE ONE PROPOSED DECISION**

**I. INTRODUCTION**

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure (Rules), the Division of Ratepayer Advocates (DRA) submits these Comments on the 5/7/07 Proposed Decision adopting the revenue requirement for California-American Water Company's (Cal-Am's) Los Angeles District (Proposed Decision or PD).

DRA supports many aspects of the Proposed Decision, including:

- Adopting the partial settlement between DRA and Cal-Am on certain revenue requirement issues.
- Establishing a return on equity (ROE) of 10.0%.
- Adopting a reduction in ROE of .50% if the Commission implements certain accounting mechanisms (Water Revenue Adjustment Mechanisms and Modified Cost Balancing Accounts) in conjunction with the conservation rate design being considered in Phase II.
- Requiring certain limitations and customer safeguards as part of the Distribution System Infrastructure Charge (DSIC) granted for routine infrastructure replacement.
- Imposing a penalty on Cal-Am for repeated violations of the notice requirement of Commission Rule 24.

DRA nevertheless recommends modifications to the Proposed Decision, including:

- Requiring additional documentation when Cal-Am files its quarterly Advice Letters for the DSIC.
- Requiring the one-time filing of a tariff that describes the procedures, numerical formulas, customer safeguards, and any requirements associated with implementing the DSIC.
- Clarification of what constitutes “non-individual projects” in the context used by the Proposed Decision.
- Increasing the amount of the penalty for Rule 24 violations to \$110,000.
- Correcting certain errors in the Proposed Decision and accompanying tables.

## **II. BACKGROUND**

This proceeding has been bifurcated into two phases, with the first phase addressing the revenue requirement for Cal-Am’s Los Angeles district, and the second phase addressing rate design. Dealing only with Phase I issues, the Proposed Decision adopts a partial settlement between Cal-Am and DRA regarding revenue requirement, with some modifications, and resolves three issues in Phase I that have remained in dispute: (1) the PD determines that Cal-Am’s return on equity should be reduced if the Commission adopts WRAMs and MCBAs in Phase II; (2) the PD rejects Cal-Am’s proposed Infrastructure System Replacement Surcharge (ISRS), but adopts a DSIC program with certain requirements, limitations, and customer safeguards, and; (3) the PD imposes a fine of \$11,000 for Cal-Am’s violations of certain Commission notice provisions.

In Phase II of this proceeding, Cal-Am and DRA negotiated a rate design for the Los Angeles district that would implement conservation rates for all customers such that the quantity rates in the summer would be higher than those at other times during the year. Residential customers would also have “inverted block rates” in which the quantity rate increases as consumption amounts increase. In addition, the Phase II settlement would adopt a Water Revenue Adjustment Mechanism (WRAM) for each service area in

Cal-Am's Los Angeles district that decouples revenues from sales. The Phase II settlement would also replace the existing cost balancing accounts for purchased power and purchased water, which only track cost variations due to changes in unit price, with Modified Cost Balancing Accounts that track cost variations due to changes in both unit price and consumption.

### III. RETURN ON EQUITY (ROE)

DRA agrees with the Proposed Decision's conclusion that "10.0% is a fair and reasonable ROE for Cal-Am."<sup>1</sup> The Proposed Decision's rejection of the CAPM model advocated by Cal-Am is appropriate and consistent with past Commission practice.<sup>2</sup> DRA also agrees that the Commission's acceptance of Cal-Am's multi-stage DCF model in this proceeding should not foreclose the Commission from considering in other cases other measurements for the constant growth factor.<sup>3</sup> Finally, DRA supports the denial of Cal-Am's request for a leverage adjustment to its ROE.<sup>4</sup>

With regard to WRAM and MCBA, DRA agrees with the PD's determination that, if the Commission adopts the conservation rates and the WRAM and MCBA accounting mechanisms in Phase II,<sup>5</sup> the Commission should also decrease Cal-Am's ROE to reflect the decrease in business risk associated with those mechanisms.<sup>6</sup> The PD reviews Commission case law with regard to revenue adjustment mechanisms in the gas, electric,

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<sup>1</sup> PD at 29.

<sup>2</sup> PD at 27-28.

<sup>3</sup> PD at 27 ("We recognize that in future cases parties may provide other measurements for the constant growth factor, and we will consider those also.").

<sup>4</sup> PD at 29-31.

<sup>5</sup> See Section II, *supra*, for a description of WRAM and MCBA.

<sup>6</sup> Findings of Fact (FOF) 17; Conclusion of Law (COL) 7.



and water utilities, and concludes that the Commission has in fact “explicitly reflected” the reduced risk associated with these mechanisms in the adopted ROEs.<sup>7</sup>

The Proposed Decision notes that the appropriate level of ROE adjustment is “a matter of informed judgment,” and looks to the Commission’s past determination to lower ROE by .2% when it allowed water companies to temporarily record sales losses in a memorandum account during a severe water drought.<sup>8</sup> The PD then finds that the WRAM and MCBA mechanisms under consideration in this proceeding go further in reducing risk than in the drought proceeding, and thus concludes that an ROE adjustment of .5% is appropriate.<sup>9</sup> While DRA has recommended that the decrease in ROE range between 1.56% and 3.28%, there is nevertheless merit in the Proposed Decision’s conclusion that “a .50% ROE adjustment is sufficient for an initial reduction.”<sup>10</sup>

#### **IV. DISTRIBUTION SYSTEM INFRASTRUCTURE CHARGE (DSIC)**

##### **A. DRA Supports The Proposed Decisions’ Limitations On The DSIC**

DRA supports the Proposed Decision’s finding that Cal-Am’s proposed Infrastructure System Replacement Surcharge (ISRS) should not be adopted because Cal-Am has not proven its need for the ratemaking mechanism, and because the ratemaking mechanism poses “substantial risks to ratepayers.”<sup>11</sup> DRA also agrees that, if an infrastructure surcharge is nevertheless granted, it should be subject to requirements that maintain a high level of regulatory oversight because “the record provides strong evidence that the existing level of regulatory oversight for Cal-Am’s Los Angeles District

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<sup>7</sup> PD at 34-39.

<sup>8</sup> PD at 37-38.

<sup>9</sup> PD at 40-41.

<sup>10</sup> PD at 41 (emphasis added).

<sup>11</sup> FOFs 18, 19, and 20.

is necessary to protect ratepayers from paying significantly higher rates for the same capital projects.”<sup>12</sup>

The Distribution System Infrastructure Charge (DSIC) program that the Proposed Decision establishes for Cal-Am contains several important limitations, including:

- The DSIC is only adopted as a pilot program subject to “full review” in the next GRC;<sup>13</sup>
- Cal-Am is directed to “explicitly address infrastructure replacement in its capital asset planning process,” and to revise its 2008 Comprehensive Planning Study (CPS) to include specific planning parameters proposed by DRA;<sup>14</sup>
- The DSIC for this rate case period can only include “the infrastructure projects reviewed and approved in this proceeding;”<sup>15</sup>
- The DSIC for the entire GRC period cannot exceed 7% of annual adopted revenues;<sup>16</sup>
- The advice letters for implementing the DSIC surcharge on ratepayers are subject to the full advice letter protest period, will be reviewed by the Water Division according to specific criteria, and must be approved by Commission resolution, and;<sup>17</sup>
- The advice letters must explain and provide documentary support (1) if the DSIC includes any projects that were not approved in this GRC, and; (2) if the cost of a project exceeded the amount authorized in this GRC.<sup>18</sup>

DRA supports these requirements because they will ensure ongoing regulatory oversight during this rate case period, as well as generate valuable information to determine whether a DSIC is appropriate for other districts and other water companies.

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<sup>12</sup> PD at 52.

<sup>13</sup> PD at 54.

<sup>14</sup> PD at 56-57.

<sup>15</sup> COL 8.a.

<sup>16</sup> PD at 55; COL 8.a.

<sup>17</sup> PD at 55-56; COL 8.b and c.

<sup>18</sup> PD at 56; COL 8.b.

**B. DRA Proposes Modifications To The DSIC In The Proposed Decision**

**1. Additional Requirements for DSIC Advice Letter**

In addition to the Proposed Decision's requirements regarding the quarterly filing of an Advice Letter for the DSIC, DRA recommends that the Commission require Cal-Am to provide with its Advice Letter sufficiently detailed supporting documentation that enables the Water Division (and DRA) to confirm, prior to the customer surcharge appearing on the bills, that: (a) projects for which the surcharge is being calculated have been completed and placed into operation, and; (b) the amounts for the quarterly DSIC surcharge were calculated correctly.

**2. Documenting the DSIC in Cal-Am's Tariff**

When other states have adopted DSIC mechanisms, implementation of the mechanism has only occurred after the specific processes and procedures appropriate for the mechanism have been established through a rulemaking proceeding and/or workshops.<sup>19</sup> If and when the Commission adopts a DSIC-like mechanism for other Cal-Am districts and Class A water utilities, DRA urges the Commission to similarly establish through a rulemaking and/or workshops the appropriate processes and procedures for implementing a DSIC.

Until such time, however, the Commission should require Cal-Am to document the specific mechanism, procedures, and safeguards of the DSIC that the Commission adopts by describing them in a tariff schedule or supplement. Using a tariff schedule or supplement to memorialize adopted DSIC procedures is consistent with the practices of other states. Such a tariff should articulate the key components of the DSIC mechanism by including appropriate excerpts from the final decision and the evidentiary record. For example, if Cal-Am's application contains certain details of the adopted DSIC that have

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<sup>19</sup> See <http://www.state.in.us/legislative/iac/T01700/A00060.PDF> (at page 15 of 42); <http://www.pabulletin.com/secure/data/vol26/26-37/1559.html>; <http://www.unitedwater.com/uwpa/pdfs/MasterTariff.pdf> (at page 59 of 63), and; <http://delcode.delaware.gov/sessionlaws/ga141/chp138.shtml>

been referenced in the record, but have not been otherwise spelled out elsewhere, those details should be contained in Cal-Am's one-time tariff describing the DSIC. The tariff should include the following:

1. A statement of purpose and applicability, and definitions of terms;
2. Descriptions and definitions of the categories of plant eligible for inclusion in a DSIC, by account number and type;
3. The formulas for calculating the fixed costs that are collected via the customer surcharge, and;
4. The DSIC requirements, procedures, and customer safeguards.

DRA recommends that the Commission require Cal-Am to file such a tariff schedule on a one-time basis within 60 days of the final decision, after consultation with DRA and the Water Division.

### **3. Additional Ordering Paragraphs**

DRA agrees with the safeguards recommended by the Commission as discussed above. In addition, DRA recommends that Cal-Am also be required to do the following:

1. Supplement the information that the company presently includes in its annual report to the Commission with:
  - a. Data detailing the revenues collected and the expenses incurred under the DSIC, and the actual amount of infrastructure replaced or rehabilitated using the DSIC compared to that authorized by the Commission in this GRC.
2. Provide interest to ratepayers if the company has over-recovered revenue during the operation of the DSIC. This interest should be at the 90-day commercial paper rate, and should be refunded to ratepayers after the next GRC during which a DSIC reconciliation occurs.
3. In addition to requiring that the company designate on its customer bills that the surcharge is a DSIC,<sup>20</sup> Cal Am should provide notifications to customers in the form of a bill insert and a public notice (published in newspapers) prior to initiating the first surcharge.
4. Provide for a "circuit breaker" that would "turn off" the DSIC and revert to the existing ratesetting mechanisms in the event that the company's rate of return exceeds its authorized rate of return. This is necessary because, if

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<sup>20</sup> PD at 56.

the company is exceeding its authorized rate of return, it clearly has ample funding in the adopted revenue requirement to address the fixed costs targeted by the DSIC. Until the next GRC, the company would then be allowed recovery only through the existing ratemaking process of filing an advice letter and obtaining a ratebase offset.

#### **4. Clarification of “Non-Individual Projects”**

The Proposed Decision includes a footnote regarding “non-individual projects” that Cal-Am proposes be part of its proposed ISRS.<sup>21</sup> The footnote states, in part:

We note here that the non-individual projects under Cal Am’s ISRS proposal, which are approximately 40% of the total ISRS projects, are less vigorously contested by DRA. If the Commission does choose to adopt an ISRS as an alternative to this proposed decision, this is the only set of projects that the record could justify as a pilot ISRS project, with the additional safeguards addressed by DRA...

While DRA continues to question the need for Cal-Am’s proposed ISRS, or even the Proposed Decision’s DSIC, DRA agrees with this footnote that only “non-individual projects” should be contained in any pilot program that adopts an ISRS defined by Cal-Am, rather than the DSIC described in the Proposed Decision. DRA recommends clarifying the footnote by adding the underlined language as follows:

We note here that the non-individual projects under Cal Am’s ISRS proposal, which are approximately 40% of the total ISRS projects, are less vigorously contested by DRA. If the Commission does choose to adopt an ISRS as an alternative to this proposed decision, this is the only set of projects that the record could justify as a pilot ISRS project, with the additional safeguards addressed by DRA. The non-individual projects are those projects such as Cal Am’s recurring projects (RP) that have been previously justified and organized under a set of decision criteria such as for example, “small main replacement”, “pump equipment improvement” or “meters – replacement.” ....

This addition more clearly defines the “non-individual projects” being discussed in the footnote.

## V. PENALTIES

DRA supports the Proposed Decision's conclusion that CAW's violations of the notice provisions of Rule 24 of the Commission's Rules merits a financial penalty. Cal-Am provides water in seven districts in California and is one of the largest, if not the largest, water utility regulated by the Commission. Cal-Am has been engaged in general rate cases before the Commission for decades. Nevertheless, for its Los Angeles rate cases over a period of 20 years, Cal-Am failed to update its GRC notices by checking the official roster of local entities published by the Secretary of State as required by Rule 24.

While the Proposed Decision acknowledges the seriousness and long duration of Cal-Am's repeated notice failures, it nevertheless imposes a penalty of only \$11,000.<sup>22</sup> DRA is concerned that the amount of this penalty is de minimus from the perspective of Cal-Am's management such that it will not serve as an effective deterrent. Per the Proposed Decision, the adopted 2007 revenue for Cal-Am's Los Angeles district is \$19,102,900.<sup>23</sup> While DRA has recommended a fine of \$110,000, even this penalty would amount to only 0.60% of the district's annual revenue. While DRA agrees with the Proposed Decision's statement that, contrary to Cal-Am's claims, "a fine is effective in sending a clear message to all utilities that failure to properly notice rate increases is a matter the Commission takes very seriously,"<sup>24</sup> the Proposed Decision's determination to impose a fine of \$11,000, or 0.06% of the district's annual revenue, does not accomplish that goal.

Regardless of the amount of the penalty imposed, DRA emphasizes that the Commission must ensure that the amount remitted by Cal-Am is charged to shareholders, rather than ratepayers. The Commission should therefore specify that Cal-Am must put

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(continued from previous page)

<sup>21</sup> PD at 53, note 73.

<sup>22</sup> PD at 61-63.

<sup>23</sup> PD, Attachment 3, at 10 of 22.

<sup>24</sup> PD at 62-63.

the penalty amount into Account 538, described as “Miscellaneous Income Deductions,” of the Uniform System of Accounts. Amounts in this account are for expenditures for which the utility will not be reimbursed.<sup>25</sup>

## VI. CORRECTIONS TO PROPOSED DECISION

DRA has identified some numerical errors in the Proposed Decision and recommends the following corrections.

- Attachment 1 to the Proposed Decision is identified at the top as a “Summary of Capital Projects Included In Rate Base If ISRS Is Not Adopted.” It is DRA’s understanding that this summary reflects capital projects in rate if a DSIC is adopted.
- Also on Attachment 1, there is an error in the amount listed for one of the projects in the first table (which identifies ISRS projects). In the second column labeled “Additions,” the year 2008 amount for Project 05500513 (a Baldwin Hills project) is listed as \$596,072, but should be changed to \$648,900.<sup>26</sup> This correction changes the ISRS IP Total (or DSIC IP Total) to \$1,056,500, and the ISRS Grand Total (or DSIC Grand Total) to \$2,045,500.
- On page 53, the Proposed Decision states that “the capital projects Cal-Am requests be placed under ISRS [DSIC] total \$2,488,098 for 2007 and \$3,020,272 for 2008.” The amount for 2008 should be \$2,045,500 to reflect the corrected ISRS Grand Total (or DSIC Grand Total) from Attachment 1.
- On pages 16-17, the Proposed Decision states that “The amended settlement tables incorporate this revised cost of debt of 6.36% for 2007, 2008, and 2009; this is a reduction of .63 each year” (footnote omitted). It appears that .63 is a calculation error that should be .53 (6.89% from the settlement minus 6.36% from the amended settlement).

## VII. CONCLUSION

DRA urges the Commission to modify the Proposed Decision as discussed above.

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<sup>25</sup> See Uniform System of Accounts for Water Utilities (Class A) (effective January 1, 1955) at 78.

<sup>26</sup> Exhibit 45 (Cal-Am and DRA Settlement Agreement on the Revenue Requirement dated June 23, 2006) at 17, Section 4.8(f) (“Garth Reservoir”).

Respectfully submitted,

/s/ NATALIE D. WALES

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May 29, 2007

Attorney for  
DIVISION OF RATEPAYER ADVOCATES



**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON PHASE ONE PROPOSED DECISION**” in **A.06-01-005** by using the following service:

[ X ] **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

[ X ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses, if any.

Executed on **May 29, 2007** at San Francisco, California.

\_\_\_\_\_/s/ ALBERT HILL

Albert Hill

**N O T I C E**

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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**PROOF OF SERVICE**

I, Cinthia Velez, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is STEEFEL, LEVITT & WEISS, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On June 20, 2007, I served the within:

***California-American Water Company Notice of Ex Parte Communications***

on the interested parties in this action addressed as follows:

***See attached service list***



**(BY PUC E-MAIL SERVICE)** By transmitting such document(s) electronically from Steefel, Levitt & Weiss, San Francisco, California, to the electronic mail addresses listed above. I am readily familiar with the practices of Steefel, Levitt & Weiss for transmitting documents by electronic mail, said practice being that in the ordinary course of business, such electronic mail is transmitted immediately after such document has been tendered for filing. Said practice also complies with Rule 1.1 of the Public Utilities Commission of the State of California and all protocols described therein.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on June 20, 2007, at San Francisco, California.

  
Cinthia Velez

**VIA PUC E-MAIL SERVICE**

**A.06-01-005**

**Last changed: June 19, 2007**

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